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IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

No. 179

OPPENHEIMER & HUTZLER, GOLDMAN SACHS & Co., GRAHAM-NEWMAN CORPORATION, NEWMAN & GRAHAM, and ARNHOLD & Co.,

Petitioners,

against

GUARANTY TRUST COMPANY OF NEW YORK, as Trustee under the First Consolidated Mortgage Deed of THE RIO GRANDE WESTERN RAILWAY COMPANY, dated April 1, 1899, JULIUS KLORFEIN, THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee under the Refunding and Improvement Mortgage of The Denver and Rio Grande Western Railroad Company's General Mortgage, dated February 1, 1924, CITY BANK FARMERS TRUST COMPANY, as Trustee under THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY'S GENERAL MORTGAGE, dated February 1, 1924, THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY, and HAROLD S. BAIRD,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE APPELLATE DIVISION OF THE SUPREME COURT FOR THE FIRST DEPARTMENT OF THE STATE OF NEW YORK

BRIEF OF RESPONDENT JULIUS KLORFEIN IN OPPOSITION

BERNARD D. FISCHMAN,
Attorney for Respondent,
Julius Klorfein.

Dated, New York, N. Y., August 7, 1961.

INDEX

	PAGE
Opinions Below	2
Jurisdiction	2
Question Involved	2
Statement of Facts	2
Argument	6
Conclusion	11

CASES CITED

Blair v. Coen, 170 F. 2d 830, 833 (C. A. 7, 1948), certiorari denied, 336 U. S. 954 (1949)	8
Boston Coal Co., In re, 47 F. Supp. 593 (M. D. Pa., 1942)	10
Brown v. Gerdes, 321 U. S. 178 (1944)	11
Callaway v. Benton, 336 U. S. 132, 147 (1949)	7
Central Hanover Bank & Trust Co., 133 F. 2d 873, 875 (C. A. 2, 1943)	7
Commercial Wholesalers, Inc. v. Investors Commercial Corp., 172 F. 2d 800, 801 (C. A. 9, 1949)	8
Diversey Bldg. Corp., In re, 86 F. 2d 456, 457-458 (C. A. 7, 1936), certiorari denied, 300 U. S. 662 (1936)	8
Farmers Loan & Trust Co. v. New York Rys. Co., 215 Fed. 712 (C. A. 2, 1914)	9
Fischer-Hansen v. Brooklyn Heights R. Co., 173 N. Y. 492, 499, 66 N. E. 395, 397 (1903)	9
Elles Co., In re, 174 F. 2d 924, 929 (C. A. 6, 1949)	10
Insurance Group v. Denver & R. G. W. R. Co., 329 U. S. 607 (1947)	3
Leiman v. Guttman, 336 U. S. 1 (1949)	11

PAGE

New York Cent. R. Co. v. New York Harlem R. Co., 85 N. Y. S. 2d 112 (Sup. Ct., 1948) 9

Ninth North Church Street, In re, 82 F. 2d 186, 188-189 (C. A. 2, 1936) 8

Nolte v. Hudson Nav. Co., 47 F. 2d 166, 167 (C. A. 2, 1931) 9

N. Y., N. H. & H. R. Co., In re, 160 F. 2d 337, 340 (C. A. 2, 1948), certiorari denied, 329 U. S. 824 (1948) 10

R. F. C. v. Denver & R. G. W. R. Co., 328 U. S. 495 (1945) 3

Rutherford Nat. Bank v. Marriello, 271 N. Y. Supp. 69, 240 App. Div. 506 (1st Dept., 1934), affirmed per curiam 266 N. Y. 568, 195 N. E. 203 (1935) 8

Southern Ry. Co. v. Peck, 34 N. Y. S. 2d 370 (Sup. Ct., 1942) 9

Sprague v. Ticonic National Bank, 307 U. S. 161, 166 (1939) 8, 9

Trustees v. Greenough, 105 U. S. 527, 532-535 (1881) 9

Woodruff v. New York, L. E. & W. R. Co., 129 N. Y. 27, 29 N. E. 251 (1891) 8, 9

Union Trust Co. v. Willsea, 275 N. Y. 164, 9 N. E. 2d 820 (1937) 8

STATUTES CITED

Bankruptcy Act (11 U. S. C., Sec. 34):
Section 16 8

Bankruptcy Act (11 U. S. C., Sec. 205):
Section 77 3
Section 77(a) 7

28 U. S. C., Section 1257(3) 2

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GUARANTY TRUST COMPANY OF NEW YORK, as Trustee under the First Consolidated Mortgage Deed of THE RIO GRANDE WESTERN RAILWAY COMPANY, dated April 1, 1899, JULIUS KLORFEIN, THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee under the Refunding and Improvement Mortgage of The Denver and Rio Grande Western Railroad Company's General Mortgage, dated February 1, 1924, CITY BANK FARMERS TRUST COMPANY, as Trustee under THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY'S GENERAL MORTGAGE, dated February 1, 1924, THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY, and HAROLD S. BAIRD,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE APPELLATE DIVISION OF THE SUPREME COURT FOR THE FIRST DEPARTMENT OF THE STATE OF NEW YORK

BRIEF OF RESPONDENT JULIUS KLORFEIN IN OPPOSITION

Opinions Below

Leave to appeal was denied without opinion by the New York Court of Appeals (R. 203-204). The Appellate Division, First Department, affirmed without opinion (R. 197-202). The opinion of the New York Supreme Court (R. 185-188) is not reported.

Jurisdiction

Leave to appeal was denied by the Court of Appeals on June 1, 1951 (R. 203-204). The order of the Appellate Division was entered February 27, 1951 (R. 197-202). The jurisdiction of this Court is invoked under 28 U. S. C. § 1257(3).

Question Involved

Whether in a proceeding to foreclose a lien on securities in which the debtor in reorganization had no interest, the state court has jurisdiction to award fees to counsel for services rendered in such proceeding.

Statement of Facts

Pursuant to motion dated August 9, 1950, petitioners sought to intervene "for the purpose of filing objections to allowances made and for rearguing the motions seeking allowances" and, for the purpose of appealing from any allowances which may be granted "out of the fund which was the subject of this action" (R. 18). The opinion of the court authorizing the allowances was filed on August 8, 1950 (R. 179-184), although the formal order was entered on September 14, 1950 (R. 12-15). The New York Supreme Court denied intervention, *inter alia,* for lack of merit (R. 185-188), and the appellate courts unanimously agreed. A summary of the pertinent facts follows:

In 1935, the Denver & Rio Grande Railroad Company filed its petition for reorganization under Section 77 of the

Bankruptcy Act (11 U. S. C. § 205). At that time it had outstanding several classes of bonds, First Consolidated Mortgage bonds (First Consolidated), Refunding & Improvement Mortgage bonds (R & I), and General Mortgage bonds (General)—all secured by various properties of the Denver company. In addition, the First Consolidated also were secured by a first lien upon 100,000 shares of the entire capital stock of the Utah Fuel Company to the extent of $6,000,000, while the R & I had a subordinate lien prior to that of the Generals. The Denver company originally owned the equity of redemption in this stock, but, as a result of a previous reorganization in 1924, one-half of the ultimate beneficial ownership was acquired by the Western Pacific Railroad Corporation and the other by the Missouri Pacific Railroad Company. In consequence, the Denver company relinquished whatever rights it ever had in the Utah Fuel stock.

A plan of reorganization for the Denver company, approved and confirmed by the District Court, was sustained on review by this Court. *R. F. C.* v. *Denver & R. G. W. R. Co.*, 328 U. S. 495 (1945); *Insurance Group* v. *Denver & R. G. W. R. Co.*, 329 U. S. 607 (1947). The plan of reorganization was consummated in 1947 and under its provisions the bondholders received new securities in amounts and proportions not here material. See tables in 328 U. S. at 503. The consummation of the plan released the debtor from any further liability on its outstanding mortgages but expressly left unaffected the respective liens on the Utah Fuel stock. The bankruptcy court did not deal with the Utah Fuel stock, since, as the trial court stated in its 1949 opinion, that stock "is not the property of the Denver & Rio Grande Western Railroad • • • That stock belongs to others", subject to the pledges or liens discussed above, 86 N. Y. S. 2d 505, 508.

Upon consummation of the plans, Guaranty Trust Company, as trustee for the First Consolidated, instituted the proceedings below to foreclose on its prior lien upon the Utah Fuel stock, asserting that the First Consolidated

bondholders had not been paid in full in the bankruptcy reorganization, and that the deficiency was far in excess of $6,000,000, for the collection of which they were entitled to proceed against the collateral pursuant to the terms of the pledge agreement (R. 78-90). As holder of $667,000 principal amount of First Consolidated bonds, Julius Klorfein applied and was allowed to intervene as a party plaintiff (R. 126), and has actively participated in the proceedings through his attorneys, a portion of whose allowance the petitioners are challenging herein. The Chase National Bank, as trustee for the R & I bondholders, filed its answer, conceding the claim of the First Consolidated and claiming only any excess over $6,000,000 which may be realized on the sale or other disposition of the Utah Fuel stock (R. 127). For reasons not here material the Generals opposed the claims of the First Consolidated and of the R & I bondholders.

In the proceedings below, the reorganized Denver company claimed the right to participate in the proceeds of the Utah Fuel stock on a parity with the publicly held First Consolidated and R & I bonds. As noted in the trial court's decision, 194 Misc. 628, 635, 86 N. Y. S. 2d 505, 511, a substantial amount of these securities had previously been pledged as collateral for loans made by the Chase National Bank and by the Reconstruction Finance Corporation (R. 68-71). Sometime after consummation of the plan, the reorganized Denver company paid these loans and the pledged bonds were duly cancelled but stamped with a legend, appearing on all bonds, which left their respective rights in the Utah Fuel stock subject to judicial determination in an independent proceeding. The claim of the reorganized Denver company was predicated upon the following: $1,395,000 face amount of First Consolidated bonds (R. 127-128), as against approximately $15,000,000 in bonds publicly held (R. 84, 148); and about $10,000,000 par amount of R & I bonds, as against $14,000,000 of face amount publicly held (R. 127, 148).

Guaranty Trust Company took no position on the Denver held First Consolidated bonds, while Chase National Bank conceded the validity of the Denver company's claim on the R & I bonds (R. 127). Counsel for respondent Klorfein opposed these claims on the ground that the Denver company, having paid its own debts, may not be subrogated to the rights of its own creditors in the Utah Fuel stock so as to displace or compete with the rights of other creditors who, admittedly, had not been paid in full. This contention was sustained by the trial court (R. 130-131, 142, 425), and affirmed on appeal to the Appellate Division. The Denver company then moved for reargument in order to establish its alleged claim for participation solely upon its holdings of R & I bonds. The motion was opposed by counsel for respondent Klorfein and was denied by the Appellate Division on June 21, 1950. The Denver company did not appeal to the Court of Appeals.

The Utah Fuel stock was sold for $6,800,000. Under the judgment of the court below, this sum, less allowances and expenses, has been substantially distributed among the First Consolidated bondholders in order of their priority, but not including the reorganized Denver company. From the figures cited above, it is readily demonstrable that the elimination of the Denver claim substantially increased the amounts distributable to the public holders of both the First Consolidated as well as the R & I bonds. The public First Consolidated bond holders receive under the judgment of the court below about $500,000 more as a result of the exclusion of the Denver claim, while to the public holders of R & I bonds, even deducting all allowances, the *net* increase to them amounts to about $200,000, since the Denver claim was about 40% of the total R & I claims against the Utah Fuel stock.

For creating or preserving this additional fund for the benefit of both classes of public bondholders, counsel for intervenor Klorfein were allowed a fee of $25,000. As the court below said in its opinion of August 8, 1950 (R. 182):

> "The issue involved the legal question as to whether the bonds in the hands of the defendant railroad were entitled to share in the recovery herein upon a parity with the publicly held bonds. Klorfein's attorneys took charge of that phase of the case, and the court's decision was in favor of the publicly held bonds. The result is that both the First Consolidated and the Refunding Improvement Mortgage bonds are excluded from the recovery herein. The publicly held bonds will therefore receive a larger share of the recovery than they otherwise would have been entitled to receive. Klorfein's attorneys thus obviously rendered a valuable service for which they are entitled to suitable compensation (Nolte v. Hudson Nav. Co., 47 F. 2d, 166, 167)."

In the order settling all allowances, entered on September 14, 1950, the court directed that of this $25,000 allowance,

> "$18,500 shall be charged against the interest of the holders of First Consolidated Bonds in the proceeds of sale, and the balance, $6,797.73 [which includes $297.73 as reimbursement for expenses] shall be charged against the interest of the holders of the Refunding and Improvement Bonds" (R. 14).

ARGUMENT

Petitioners will readily concede that the exclusion of the Denver held R & I bonds substantially increased, as noted above, the amount distributable to the public holders of R & I bonds, and that this addition to their share in the fund was produced by the sole efforts of Klorfein's counsel. It is equally clear from their moving papers and their petition herein that no objection, as such, is raised to the amount awarded to counsel. Their sole contention is that the court below did not have jurisdiction to determine the allowances to counsel; that the bankruptcy court has sole power to award such allowances; and that such allowances are to be paid by the reorganized Denver

company and not out of the fund which counsel for Klorfein had created for the benefit of the R & I bondholders. As for the allowance to counsel for respondent Klorfein, their objection is of course directed only to so much of the order below which directs payment of about $6,900 out of the interests of the R & I bondholders in the fund (R. 14). Obviously, as R & I bondholders, they have no standing to challenge the allowance of $18,500 payable to counsel out of the proceeds to be distributed to the First Consolidated bondholders.

We submit that the petition should be denied because it presents no issue requiring review by this Court. The controversy over the disposition of the Utah Fuel stock was adjudicated in the New York state court because it involved no asset or interest of the debtor within the cognizance of the bankruptcy court. The power of the state court, as a court of equity, to award the fees in question is incidental to the adjudication of that controversy.

1. Under Section 77(a) (11 U. S. C. § 205(a)), exclusive jurisdiction of the bankruptcy court extends to "the debtor and its property", and "as a corollary, over any rights that may be asserted against it," *Callaway* v. *Benton,* 336 U. S. 132, 147 (1949). The bankruptcy court has no jurisdiction to adjudicate rights or controversies in which the debtor has no interest and which do not affect the proper adminstration of the estate. In such situations the parties are remitted to other courts which could more appropriately deal with the issues involved. See *Callaway* v. *Benton,* 336 U. S. 132, 142-143 (1949); *Central Hanover Bank & Trust Co.,* 133 F. 2d 873, 875 (C. A. 2, 1943).

Petitioners do not dispute these elementary principles of bankruptcy reorganization. Nor can it be seriously questioned that at the time when the reorganization proceedings were begun, the Utah Fuel stock was not property of the Denver company. This stock was originally pledged as additional collateral for the various bond issues, and with the transfer of the equity of re-

demption in 1924, this Court noted, the Denver company relinquished whatever right it ever had in the Utah Fuel stock, 328 U. S. at 528. See also *Blair* v. *Coen,* 170 F. 2d 830, 833 (C. A. 7, 1948), certiorari denied, 336 U. S. 954 (1949). The Utah Fuel stock thus became accommodation collateral, which in substance is but a suretyship arrangement to the extent of the pledge. See *Rutherford Nat. Bank* v. *Marriello,* 271 N. Y. Supp. 69, 240 App. Div. 506 (1st Dept. 934), affirmed per curiam 266 N. Y. 568, 195 N. E. 203 (1935). In substance therefore, the suit instituted below as an action for a deficiency claim against a guarantor whose liability to the creditors is, under Section 16 of the Bankruptcy Act (11 U. S. C. § 34), not affected by the discharge of the debtor in bankruptcy. *Union Trust Co.* v. *Willsea,* 275 N. Y. 164, 9 N. E. 2d 820 (1937). Jurisdiction over such a suit accordingly, cannot be asserted in the bankruptcy court. *In re Ninth North Church Street,* 82 F. 2d 186, 188-189 (C. A. 2, 1936); *In re Diversey Bldg. Corp.,* 86 F. 2d 456, 457-458 (C. A. 7, 1936), certiorari denied, 300 U. S. 662 (1936); *Commercial Wholesalers, Inc.* v. *Investors Commercial Corp.,* 172 F. 2d 800, 801 (C. A. 9, 1949).

Jurisdiction over the disposition of the Utah Fuel stock necessarily was vested in the state court below, and as a court of equity having control over the stock, which was no part of the debtor's assets, it has also the incidental inherent power to make allowances chargeable to the fund or against the proportionate share of each class of beneficiaries. "Plainly the foundation for the historic practice of granting reimbursement for the cost of litigation other than the conventional taxable costs is part of the original authority of the chancellor to do equity in a particular situation." *Sprague* v. *Ticonic National Bank,* 307 U. S. 161, 166 (1939); *Woodruff* v. *New York, L. E. & W. R. Co.,* 129 N. Y. 27, 29 N. E. 251 (1891). As the court below stated (555-561):

"The federal courts therefore left to this court the right and duty to foreclose the liens on that stock, and to do whatever else was necessary and incidental to such a foreclosure; to the end that this property (not within the federal jurisdiction) might be effectually and completely dealt with.

* * * * * *

An inevitable part of this power was, therefore, the authority to decide and determine upon the allowances to be made to the parties and their counsel; not only was there authority for such allowance in the mortgages under foreclosure, but also in the inherent power of the court in such an equity action."

* * * * * *

2. Petitioners do not deny that counsel for respondent Klorfein was instrumental in establishing or preserving a fund for the benefit of the R & I bondholders. It follows that the allowances to counsel are properly chargeable to that fund. This is so well established and so widely accepted that a detailed discussion thereof is not necessary. We respectfully invite this Court's attention to *Trustees* v. *Greenough,* 105 U. S. 527, 532-535 (1881); *Sprague* v. *Ticonic National Bank,* 307 U. S. 161, 166-167 (1939); *Nolte* v. *Hudson Nav. Co.,* 47 F. 2d 166, 167 (C. A. 2, 1931); *Farmers Loan & Trust Co.* v. *New York Rys. Co.,* 215 Fed. 712 (C. A. 2, 1914); *Woodruff* v. *New York L. E. & W. R. Co.,* 129 N. Y. 27, 29 N. E. 251 (1891); *Southern Ry Co.* v. *Peck,* 34 N. Y. S. 2d 370 (Sup. Ct. 1942); *New York Cent. R. Co.* v. *New York Harlem R. Co.,* 85 N. Y. S. 2d 112 (Sup. Ct. 1948), and cases there cited. Indeed the benefits thus conferred gives also rise to a lien upon the fund under Section 475 of the Judiciary Law which provides that an attorney has "a lien upon his client's cause of action * * * which attaches to a * * * judgment or final order in his client's favor * * * or the proceeds thereof." See *Fischer-Hansen* v. *Brooklyn Heights R. Co.,* 173 N. Y. 492, 499, 66 N. E. 395, 397 (1903). The absence of a formal retainer is immaterial. *Farmers Loan & Trust Co.* v. *New York Rys. Co.,* 215 Fed. 712 (C. A. 2, 1914).

As beneficiaries of these services, petitioners cannot remit us to another tribunal, which neither has jurisdiction over the controversy nor control over the fund, in order to seek compensation from an adversary party whose right to participate in the fund we have defeated.

Petitioners rely on paragraph 19 of the Consummation Order and Final decree (R. 68). That provision cannot be construed as petitioners suggest. This Court has said that for lack of jurisdiction the plan "did not affect existing rights in the collateral" (328 U. S. at 530, 531) and for the same reason could not undertake to control the matter of fees incident to the disposition of the Utah Fuel stock (R. 64-65). We recognize that in its final decree the bankruptcy court may retain jurisdiction to prevent interference with the execution and operation of the plan, *In re N. Y., N. H. & H. R. Co.*, 160 F. 2d 337, 340 (C. A. 2, 1948), certiorari denied, 329 U. S. 824 (1948); but it cannot do so for the purpose of dealing with matters which are unaffected by the plan and which are beyond the power of the bankruptcy court, *In re Elles Co.*, 174 F. 2d 924, 929 (C. A. 6, 1949); *In re Boston Coal Co.*, 47 F. Supp. 593 (M. D. Pa. 1942). As the trial court said (R. 187):

> "I see nothing in the Colorado decree which compels me to any different result. It cannot, in my opinion, be construed in one breath to renounce jurisdiction over the Utah Fuel stock in favor of this court, and in the next breath, nevertheless, seek to withhold from this court a necessary part of such jurisdiction. Particularly may no such construction be indulged in, since it is clear that the federal court had, and could have, no power over that stock, as it was no part of the property of the debtor."

In any event, to the extent that the consummation order may represent a voluntary undertaking by the reorganized debtor to pay allowances and expenses, it has no relation to the allowance of counsel for respondent Klorfein. The order specifically refers to the indenture trustees only. The controversy raised by the Denver-held

bonds does not even appear to have been contemplated at the time of consummation. The latter controversy first arose after consummation when the reorganized Denver company paid off the loans assumed or extended by the plan. It is hardly likely that the Denver company would consciously assume payment of fees of counsel instrumental in defeating its asserted right to participate in the Utah Fuel stock.

The decisions of this Court in *Leiman* v. *Guttman,* 336 U. S. 1 (1949), and *Brown* v. *Gerdes,* 321 U. S. 178 (1944), do not support petitioners' argument. Theses cases hold that the bankruptcy court has paramount jurisdiction over all fee claims payable by the estate or chargeable against the interests of the estate, or where the fees in question are for services rendered in the bankruptcy proceedings by persons acting in a representative or fiduciary capacity in reorganization. This is an aid of policy of Chapter X of the Bankruptcy Act to secure a fair and equitable reorganization which would be impaired by excessive fees; and under the statute only the bankruptcy court has the judicial responsibility to effectuate that basic policy. No such considerations are applicable to the allowances in question since the subject matter of the controversy is not an interest of the debtor and is beyond the reach of the Bankruptcy Act.

CONCLUSION

The judgment below is correct. There is no conflict with the decisions of this Court. The petition should be denied for lack of merit and for want of a substantial federal question.

Respectfully submitted,

BERNARD D. FISCHMAN,
Attorney for Respondent,
Julius Klorfein.

Dated, New York, N. Y., August 7, 1951.